Preface

Bank panics have always mattered, because they are devastating to national economies, creating recessions and sometimes depressions. Previously, bank panics were national, depressing only a nation. But now they can be global, capable of breaking the economies of not one but several nations. The reason that bank panics are now global is due to information technology (computers and the Internet), which has stitched together a global financial system. But the whole global financial system is unregulated. Can we understand how such a global financial system evolved, but with technology so far ahead of proper regulation?

And why do bank panics still occur? Despite over a hundred years of modern economic theory and many excellent historical studies about bank panics, panics are still poorly understood and certainly not yet preventable. Partly this has been a failure of modern economic theory about bank panics. Economics has been a narrow and single discipline, while bank panics are a complex societal phenomena.

For example, within the historical context of the Euro-bank crisis beginning in 2010, there occurred in 2013 the collapse of the banks of Greek Cyprus. In this Cypriot bank panic, there was again something common to the histories of all bank panics—just plain, old-fashioned, bad banking practices. Cypriot banks were serving as an “offshore” bank for tax evasion and money laundering—bad practices. But exacerbating the harm was the leverage effect upon the Euro-bank system with the computerized Internet connection of Cypriot banks to Europe and Russia, all without proper regulation.

Landon Thomas Jr. reported: “NICOSIA, Cyprus—With time running out until Cyprus’s devastated banks must reopen their doors to the public, Cypriot and European officials are scrambling to put in place a set of measures that would allow jittery depositors access to their savings while preventing many billions of euros from fleeing the country. But the situation is now looking even worse than anticipated… (There is) the shock that the island’s small economy has endured from the extended closure of its banks.” (Thomas 2013a)

When all the banks close, a modern economy stops. Shops close. Employees are not paid. Factories shut down. Tourists do not vacation. The government cannot finance services. Modern economies run on money. Banks are the transmitters of
money, the agency of financial transactions. Even the banks’ automated teller machines need to be resupplied frequently with cash.

But when banks close, who fixes them? Governments. Landon Thomas further reported: “The bailout package being put together by the troika of international lenders—the International Monetary Fund, the European Central Bank and the European Commission—will consist of about 10 billion euros ($12.9 billion dollars) in loans for Cyprus itself.” (Thomas 2013a)

But when banks fail, who bears the cost? Depositors, shareholders, and bank employees. Landon Thomas wrote: “The cost of bailing out the island’s two largest banks, Bank of Cyprus and Laiki Bank, is to be borne by the banks’ large but uninsured depositors. At a news conference on Tuesday, the governor of Cyprus’s central bank, Panicos O. Demetriades, said that he expected big depositors at the Bank of Cyprus to get a ‘haircut,’ or loss, of about 40 percent on their 14 billion euros in long-term deposits. In exchange, depositors will receive shares in a recapitalized bank.” (Thomas 2013a)

Depositors are important to opening a bank again. But there were two kinds of depositors in Cypriot banks: Cypriot citizens and wealthy Russians. Tony Barber commented: “Cyprus acquired dubious friends, such as Slobodan Milosevic, the Serbian dictator whose war-mongering regime, hit by Western sanctions, used the island for financial operations. Post-communist Russians came to Cyprus too.” (Barber 2013)

Cyprus’ financial business was principally for foreign depositors wanting a “lightly taxed hideaway for cash.” Why in the world is there a need for such hideaways? To avoid taxes and to launder illegally acquired wealth. Peter Siegel, Karin Hope, and Quentin Peel reported: “…Nicos Anastasiades (a lawyer and career politician) had assumed the country’s presidency just two weeks earlier. Like many in Cyprus, he has ties to Russian interests—his family law practice has two Russian billionaires on its books. And other members of the Cypriot governing class felt pressure to protect the country’s banking sector, which counts Russians among its most important customers. Failing to grasp the depth of such ties would prove a fatal blind spot (to European officials). ‘The discussion in Cyprus was not about small savers,’ says a senior German official. ‘It was about people who fly in Lear jets.’ By the end of the week (March 18–24), there would be 13 private jets belonging to Russian owners of Cypriot companies parked at Larnaca International Airport, ready to decamp with millions held in the two main banks. Cyprus has long been a popular tax haven for Russian businessmen, legitimate and not.” (Spiegel et al. 2013)

The Cypriot bank panic was not just about the euro banking system (which is studied in the discipline of economics), but it was also about the ties between Cypriot politicians and Russian billionaires (which is studied in the discipline of sociology and political science). Thus to understand the Cypriot bank panic, one needs a cross-disciplinary social science perspective.

Would the European regulatory officials let the Lear jets fly away from Cyprus, with the millions of euros deposited by wealthy Russians? Apparently not. Liz Alderman reported: “The Cypriot government on Wednesday announced severe
restrictions on access to funds held in the country’s banks, hoping to curb what is nonetheless likely to be a rush to withdraw money when the banks open Thursday (March 28) for the first time in nearly two weeks. The measures, which are supposed to be in effect for only a week but could be extended, will prohibit electronic transfers of funds from Cyprus to other countries. In addition, individuals will not be allowed to take more than 3,000 euros in cash outside the country, well below the current ceiling of 10,000 euros, or $13,000. The cap on withdrawals from automated teller machines will rise to 300 euros per day from 100 euros, but credit and debit card charges will be capped at 5,000 euros per person per month. Banks will not cash checks, though they will accept checks as deposits. Bank clients will also not be able to withdraw money from fixed-term deposits before their maturity date” (Alderman 2013a).

Russian political influence was important in Cyprus but not so important in Europe. Landon Thomas further reported: “Might the largest shareholder of the troubled Bank of Cyprus end up being a Russian oligarch, furious that he’s just lost a lot of his money in the bank’s bailout? That conceivably could happen under the terms by which big depositors in the Bank of Cyprus, the country’s biggest, will be forced to help pay for the international bailout of the Cypriot banking industry… By Wednesday evening it was not known how much of a loss, or haircut, would be demanded from depositors on their amounts exceeding 100,000, or $128,000. The figure of 40 percent was commonly cited by people involved in the assessment, but that number could go higher…” (Thomas 2013b).

What was the failure here? It had been failure in bank regulation. Liz Alderman summarized: “Banking experts say that the reason Cyprus, as well as Spain and Ireland, have needed bailouts is because Brussels has left to national regulators the very large responsibility of ensuring that their banks do not engage in risky conduct that could threaten the broader euro monetary system. In the case of Spain and Ireland, it was banks lending recklessly in real estate bubbles; with Cyprus, it was having too large an exposure to Greek government bonds. ‘What we really need is to have stronger central control of banks on a Europe-wide basis,’ said Karel Lannoo, the chief executive of the Brussels-based Center for European Policy Studies and an expert on bank regulation in Europe. ‘Capital controls result from bad bank behavior,’ he said. ‘We need to have unified regulations with regard to how banks conduct their business.’” (Alderman 2013a, b)

What is important in the regulation of financial systems is to balance a public good against private good in banking. This distinction between public and private good can be vividly seen in the impacts of the Cypriot bank bailout upon its two classes of depositors: Cypriot citizens and Russian oligarchs.

About the tragedy for Greek Cypriots, Landon Thomas reported: “For 20 years, Mr. Agrotis was a stockbroker at the Bank of Cyprus, the country’s largest financial institution, and until the shares were recently wiped out, he and his family had much of their wealth tied up in the bank via shares, bonds, retirement funds and—now—frozen deposits. Under terms of the bailout, shareholders’ equity in the bank has been eliminated… Within Cyprus, as the realization sinks in of how badly the national economy might be ravaged by the combination of capital controls on the
flow of money out of the country and an indefinite freeze on the bulk of bank deposits, frustration is flaming into full rage.” (Thomas 2013c)

Joe Nocera had no sympathy for the Russians using the Cypriot banks: “I realize this is a somewhat irresponsible thought, but I keep wondering why anyone should care if some Russian oligarchs and businesses—and corrupt officials—lose a bundle in Cyprus… It turns out that much of the hot money held in the Cypriot banking system is Russian. Russian companies like the low taxes that come with having entities in Cyprus. Because of the wink, wink, nod, nod relationship between Cyprus and Russia, rubles deposited in Cypriot banks are as untraceable as dollars once were in Swiss bank accounts… Corrupt officials who embezzle money have long found Cyprus to be a friendly haven.” (Nocera 2013a, b)

Bank panics, stability of financial systems, societal benefits of banking, and proper regulation of global financial systems are topics for a cross-disciplinary review of bank panics and economic theory. Bank panics continue to matter. Information technology, applied to financial technology in banking systems, now makes panics matter even more. How can the global financial system be made to properly work?

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References

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